

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Commonwealth Edison Company,)
Commonwealth Edison Company of)
Indiana, Inc.,)
IES Utilities Inc.,)
Interstate Power Company, and)
MidAmerican Energy Company)

Docket No. EL00-25-000

**COMMENTS OF THE
ILLINOIS COMMERCE COMMISSION**

I. INTRODUCTION

The Illinois Commerce Commission (“ICC”) is the state agency responsible for regulating retail electric service in Illinois. Furthermore, Illinois law requires the ICC to promote an effective retail and wholesale electricity market. Of the Petitioners in the instant docket, Commonwealth Edison, MidAmerican Energy, and Interstate Power serve retail customers in Illinois. Petitioners' independent transmission company (“ITC”) proposal would, therefore, have a significant impact on Illinois.

The ICC urges the Commission not to grant the declaratory order requested by Petitioners at this time. See, Stowers Oil and Gas, 27 FERC ¶61,001 (1984)(holding that Commission action on petitions for declaratory orders is discretionary). The ITC proposed by Petitioners reflects an inadequate geographic scope to effectively perform the RTO functions identified by the Commission in Order 2000. Petitioners also propose inappropriate incentive/performance rates and an insufficiently developed ITC corporate structure. Furthermore, it would be premature for the Commission to decide

many of the issues Petitioners pose because of the partially developed nature of Petitioners' ITC and the sketchy explanation of the proposal in their filing.

II. SUMMARY OF PETITIONERS' REQUEST FOR DECLARATORY ORDER

The five petitioners¹ are not, at this time, requesting Commission approval of their proposed ITC. Rather, they request that the Commission issue an Order under the Commission's declaratory order authority declaring that²:

- (1) the ITC outlined in the petition will meet or exceed the minimum characteristics and functions for RTOs proposed in the RTO NOPR or adopted in any final rule;
- (2) the incentive and performance-based rate mechanisms outlined in the petition are appropriate ratemaking measures for encouraging voluntary formation of, and enhanced performance by, an ITC; and
- (3) it is appropriate to assign to the proposed ITC the Midwest ISO functions that the recently-proposed Appendix I to the Midwest ISO Agreement contemplates may be assumed by an ITC.

Petition at 1-2. As will be demonstrated below, based upon the material in the Petition, the Commission should deny each of these requests.

III. ICC POSITION AND RECOMMENDATION

The ICC is not opposed to the concept of ITCs. An electric industry structure featuring large ITCs operating under an even larger independent system operator ("ISO") structure may have many benefits for reliable system operation and electricity competition. For example, an ITC could consolidate ownership and operation of

¹ In reality, there are only three petitioners because Commonwealth Edison and Commonwealth Edison of Indiana are both subsidiaries of Unicom and Interstate Power and IES Utilities are both subsidiaries of Alliant Corp.

² Declaratory orders may be issued to terminate a controversy or remove uncertainty. 18 C.F.R. §385.207(a)(3). It is presumed that Petitioners' request for declaratory order falls primarily into the latter category—that is, it requests that the Commission remove

transmission facilities in a single entity which could improve the efficiency and entrepreneurial dynamics of transmission system operation as compared with separating operation from ownership under an “independent system operator (“ISO”) structure.

The ICC supports FERC’s open architecture principle requiring RTO design and structure to have the flexibility to evolve over time to improve “geographic scope, market support and operations to meet market needs. RTO Rule at 502. The ICC encourages continued exploration into the development of ITC options which would exhibit the characteristics and exercise the functions that FERC found appropriate for regional entities in the RTO Rule.

However, the Petitioners’ ITC proposal, even in its current sketchy outline form, features provisions that the Commission should not approve. Among the proposal’s flaws are: (1) provisions and features which are inconsistent with FERC’s RTO Rule 2000, namely, insufficient geographic scope to effectively manage congestion, parallel path flow, and efficient system expansion; (2) inappropriate incentive and performance rate mechanisms that are not necessary to encourage voluntary formation of RTOs and have not been shown to produce benefits in excess of their costs; (3) the proposal is premature because it would not be appropriate for the Commission to address Petitioners’ ITC proposal until the Commission has ruled on the Midwest ISO’s application for approval of Appendix I (concerning the development of ITCs under the Midwest ISO and the transfer of ISO functions to those ITCs) in Docket ER00-448-000; and (4) an insufficiently developed proposal for ITC corporate structure.

some asserted uncertainty.

It is the ICC's position that: (1) an ITC must be of sufficient geographic size and scope to satisfy, by itself, the minimum standards of RTO Rule 2000 with respect to operations, planning, and any other function for which the ITC will have primary responsibility; (2) the Commission should not authorize incentive rate programs which are not necessary to encourage voluntary formation of RTOs and which have not been shown to produce benefits in excess of their costs; (3) Petitioners' request for declaratory order concerning the Midwest ISO Appendix I is, at best, premature and may not be an appropriate subject for a Commission declaratory order in any event; and (4) Petitioners have not demonstrated that the proposed corporate structure for the ITC provides any advantages over the existing Midwest ISO corporate structure.

If the Commission does choose to respond to the Petitioners' request for declaratory order, the ICC urges the Commission to narrowly construct its order to removing uncertainty as to how Order 2000 would apply to Petitioners' proposal. The ICC suggests that sweeping generalizations about ITCs or the binary RTO concept are not appropriate at this time given the sketchy nature of Petitioners' proposal.

IV. BACKGROUND

In December, 1997, Illinois Governor Jim Edgar signed into law the Electric Service Customer Choice and Rate Relief Law of 1997 ("Customer Choice Law"). 220 ILCS 5/16-101, et seq. The law adopts a phased-in approach to retail direct access in Illinois. Id. at §16-103. The first group of retail customers became eligible for retail direct access on October 1, 1999, and all retail customers will be eligible by May 1, 2002. Id. at §16-104(a)(1). The Customer Choice Law states that the Illinois General Assembly "finds that the establishment of one or more independent system operators or

their functional equivalents is required to facilitate the development of an open and efficient marketplace for electric power and energy to the benefit of Illinois consumers.” Id. at §16-126(a). Accordingly, the Customer Choice Law required each Illinois electric utility that is a member of the Mid-America Interconnected Network (“MAIN”) to submit to the Commission an application for establishing or joining an independent system operator that meets specified standards. Id.

In 1999, the ICC found that membership in the Midwest ISO would satisfy the specific standards established by Section 16-126 of the Customer Choice Law. Order, Illinois Commerce Commission on its Own Motion v. Central Illinois Light Company, et al., Implementation of Section 16-126 of the Public Utilities Act regarding establishment of an independent system operator in Illinois, ICC Docket No. 98-0818 at 4 (May 10, 1999). However, the Petition contemplates the delegation of certain responsibilities from the Midwest ISO to the Petitioners’ proposed ITC. The ICC has not examined whether or not this proposed structure would comport with the provisions of Section 16-126 of the Customer Choice Law. In any event, the Petition merely seeks a declaratory order that the Petitioners’ proposed corporate structure satisfies the Commission’s minimum standards for an RTO. Accordingly, the issue of compliance with the Illinois Customer Choice Law is beyond the scope of this FERC proceeding. The ICC merely notes Section 16-126’s requirements here so that FERC and the parties are aware that those requirements may need to be addressed in a future ICC proceeding if the Petitioners actually make an ITC filing that proposes the corporate structure that is at issue in this proceeding.

The Customer Choice Law also required the ICC to promote an effective competitive retail and wholesale electricity market for Illinois by stating:

A competitive wholesale and retail market must benefit all Illinois citizens. The Illinois Commerce Commission should act to promote the development of an effectively competitive electricity market that operates efficiently and is equitable to all consumers. Consumer protections must be in place to ensure that all customers continue to receive safe, reliable, affordable, and environmentally safe electric service.

220 ILCS 5/16-101A(d).

The ICC has been very active in the Commission's efforts to develop its RTO policy and to create an appropriate RTO in the Midwest region. For example,

- (1) the ICC was part of the eleven-state contingent that submitted a petition for technical conference or regional hearing on regional transmission issues in February, 1998;
- (2) the ICC submitted Comments on two occasions in Docket PL98-5-000 (Inquiry Concerning the Commission's Policy on Independent System Operators);
- (3) the ICC has been active in the Midwest ISO dockets (ER98-1438/EC98-24), filing Comments with the Commission in those dockets on March 16, 1998. The ICC's request for rehearing of the Commission's September 16, 1998, Order in the Midwest ISO dockets is still pending at the Commission;
- (4) the ICC filed Comments in the Alliance RTO dockets (ER99-3144/EC99-80) on July 7, 1999; and
- (5) the ICC participated in the regional meetings in Docket RM99-2-000 and submitted Comments in that proceeding on August 11, 1999.

The ICC also continues to participate in the development of the Midwest ISO through its regulatory representatives on the Midwest ISO Advisory Committee. These activities illustrate the ICC's high level of interest in regional transmission issues and commitment to assist in the timely development of an appropriate RTO in the Midwest region.

In previous Comments to the Commission, the ICC has urged the Commission to assert the authority that it has under the Federal Power Act to mandate the timely development of an appropriately constituted RTO in the Midwest. See e.g., ICC RTO NOPR Comments at 5. Nevertheless, the Commission has declined to exercise its statutory authority and has decided, at least for the time being, to pursue the voluntary approach to RTO development through specification of minimum criteria and functions and through mandatory filing requirements. See, Order No. 2000, Regional Transmission Organizations, 89 FERC 61,285 (Dec. 20, 1999)(“RTO Order 2000”). The ICC continues to believe that stronger expressions of Commission authority with respect to the development and timely implementation of appropriate RTOs would eliminate the regulatory uncertainty that fosters proposals such as that of the Petitioners.

The ICC recognizes that, at this stage of RTO development, a certain amount of experimentation and creativity may well be beneficial in the long run. The ICC encourages continued improvements in RTO structure and design. These improvements may involve incorporation of ITC arrangements. Nevertheless, the Petitioners’ binary RTO proposal, and the shifting of RTO responsibilities that it represents, merits very careful review by all involved lest it be permitted to undo all of the positive momentum that has built up behind the growth and development of the Midwest ISO.

V. SUMMARY OF PETITIONERS’ BINARY RTO PROPOSAL

Petitioners propose a so-called “binary RTO” concept in which an ITC would operate in conjunction with the Midwest ISO, and, together, would reflect all of the

minimum characteristics and perform all of the minimum functions specified in RTO Order 2000. Petitioners, therefore, propose a complex mix of RTO responsibilities, characteristics, and functions—some of which would be assigned to the ITC, some of which would be assigned to the Midwest ISO, and some of which would be shared between the ITC and the Midwest ISO.

According to the Petitioners' proposal, an ITC would:

- Administer its own rate schedules and employ a transmission pricing system that will promote efficient use and expansion of transmission and generating facilities;
- Create market mechanisms to manage and accurately price transmission congestion, including mechanisms to encourage market-driven investments in new generation, load management and transmission upgrades to relieve congestion;
- Develop and implement procedures to address parallel path flow issues, including market-based alternatives to TLR curtailments, in conjunction with the Midwest ISO; and
- Serve as a supplier of last resort for all ancillary services required in Order No. 888 and subsequent orders, including providing a bid-based regional balancing market and bid-based markets to acquire regulation and operating reserves for the ITC regions.

Petition at 11-12.

Also according to Petitioners' proposal, the ITC, in coordination with the Midwest ISO would:

- Plan and coordinate necessary transmission additions and upgrades, including generator interconnections, using both market-funded and rate-funded investments;
- Establish ratings and operating procedures for facilities under its control;
- Set its own transmission maintenance and outage schedules; and

- Coordinate generator maintenance for generators within the ITC, for those generators that are required to coordinate maintenance pursuant to Appendix E. Section VII of the Midwest ISO Agreement.

Petition at 12.

Finally, according to Petitioners' proposal, the Midwest ISO would:

- Operate a single OASIS site for all transmission facilities under its control;
- Independently calculate TTC and ATC in consultation with any ITC operating in its territory;
- Act as the NERC Regional Security Coordinator;
- Monitor all markets operated or supervised by the ITC, to identify design flaws and market power;
- Monitor transmission expansion activities of an ITC; and
- Continue to organize and facilitate market participant and state regulator input into regional transmission and market issues through its advisory committee.

Petition at 12-13.

The Commission should have no doubt that the arrangement of RTO characteristics and functions described above is entirely at odds with the characteristics and functions that the Commission assigned to the Midwest ISO in its Order conditionally Authorizing Establishment of Midwest Independent Transmission System Operator and Establishing Hearings issued September 16, 1998. The Commission should also have no doubt that, as proposed by Petitioners, the ITC will be the system operator and perform most key RTO functions. Even the functions which the Petitioners identify as "coordinated" with the Midwest ISO will be predominantly conducted by the ITC. The Midwest ISO, on the other hand, will be left with few functions, most of which are currently being performed, at least for ComEd, by MAIN

(security coordinator, ATC calculator, and OASIS site operator) or are not functions that an ITC would want to perform anyway (market monitoring and facilitation of state regulator input).

VI. DISCUSSION

A. Geographic Scope and Size

In the RTO NOPR, the Commission suggested that a region that is large in scope would best facilitate the effective performance of many of an RTO's functions. FERC Stats. & Regs. at 33,730. While the Commission also acknowledged that there may be factors that might limit how large an RTO should be, the Commission explained that the scope and configuration of the regions in which RTOs are to operate will significantly affect how well they will be able to achieve the necessary regulatory, reliability, operational, and competitive benefits.

The RTO Order 2000 adopted the NOPR proposal regarding appropriate scope and configuration. RTO Order 2000 at 246. In RTO Order 2000, the Commission states that an appropriate region is one of sufficient scope and configuration that permits the RTO to effectively perform its required functions and to support efficient and nondiscriminatory power markets.

The ICC recognizes that the Petitioners request the Commission not to address the issue of appropriate geographic scope and size for the ITC proposed in this proceeding. The Petition states: "Petitioners ask the Commission to evaluate all other aspects of their proposal, and to defer the question of appropriate scope until they file an ITC." Petition at 4. Nevertheless, appropriate geographic size and scope are key issues in evaluating Petitioners' ITC proposal. Evaluation of Petitioners' ITC proposal

(in particular, proposals for congestion management, parallel path flow, and transmission system planning and expansion) cannot be conducted without taking into account the geographic scope and size of the ITC underlying the proposal.

Petitioners' proposed ITC involving only the facilities of the three applicants fails to achieve sufficient scope or geographic size as required by the RTO Order 2000. While the proposed ITC would encompass a substantial portion of the load served in Illinois and Iowa, it would be too small to meaningfully perform its proposed functions and at the same time effectively contribute to the development of an efficient power market in the Midwest. Indeed, in its March, 1998, Comments to FERC on the Midwest ISO application, the ICC observed that the Midwest ISO should be larger and that the Midwest ISO's geographic configuration is "far from ideal" for a regional transmission entity in the Midwest. ICC Midwest ISO Comments at 3. The ICC observed that the "goals of non-discriminatory transmission service over a broad area, maintaining or enhancing regional system reliability, and facilitating regional competitive markets" can only be obtained in the Midwest through the operation of an appropriately constituted large regional transmission entity. Id.

The ICC also notes the Commission's observation that an RTO could propose a configuration that interferes with the formation of a larger, more appropriately configured RTO. RTO Order 2000 at 247. Such may be the case here. In its Comments on the Alliance RTO application, the ICC urged the Commission not to approve two competing RTOs in the Midwest region if such approval would prevent the development of an effective RTO in the Midwest. ICC Comments, Alliance Companies, Docket Nos. ER99-3144-000/EC99-80-000, consol. at 3 (July 7, 1999). The current

limited geographic scope of Petitioners' proposed ITC may interfere with the continuing formation and development of a larger, more appropriately configured, RTO in the Midwest region.

1. Congestion Management

Due to its insufficient geographic scope and size, the proposed ITC will not be capable of performing the functions outlined in the Petition at a level superior to the Midwest ISO. For example, the ITC will be responsible for creating and implementing market mechanisms to manage and accurately price transmission congestion. Petition at 11. Congestion management is best addressed through the internalization of the problem within an RTO of large scope and configuration so that adequate tools can be directed at the problem. It is crucial that RTOs provide transmission users with region-wide, standard, congestion management. Due to its limited scope and size, it is unlikely that the proposed ITC will be able to effectively address the problem of congestion as well a large regional entity, such as the Midwest ISO, could.

2. Parallel Path Flow

In the RTO Order 2000, the Commission stated that an RTO should develop and implement procedures to address parallel path flow issues within its region and with other regions. RTO Order 2000 at 390. Parallel path flow problems are closely associated with congestion management and, like congestion management, it is the large geographic scope of the RTO that will allow the internalization of the negative effects that parallel path flows present. With such a limited geographic scope, the ITC proposed by Petitioners would be an unlikely candidate to efficiently manage the impacts of parallel path flow.

3. Transmission Planning and Construction

Long term congestion relief may involve the construction of transmission facilities. The RTO Order specifies that the Commission expects an RTO to have ultimate responsibility for both transmission planning and expansion within its region. RTO Order 2000 at 486. The rationale for this requirement is that it is most efficient for a single large entity to coordinate these actions, thereby insuring a least cost outcome that maintains or improves existing regional reliability levels. The Commission also notes that, in the absence of a single entity performing these functions, there is a danger that separate transmission investments will work at cross-purposes and possibly even hurt reliability.

The Petition states that the ITC will plan and coordinate transmission additions and upgrades, including generator interconnects, with the Midwest ISO. Petition at 11. However, the Midwest ISO would have no authority to direct the ITC to locate these facilities in the optimal location. An ITC's sub-optimal geographic scope and size could, therefore, interfere with efficient regional system expansion.

B. Incentive Rates and Performance-Based Rates

Petitioners propose a whole panoply of incentive and performance-based rate adders. First, Petitioners propose that the ITC's return on equity ("ROE") be set at the higher of: (1) the ROE allowed by the Commission for the Midwest ISO; or (2) the current allowed return on investment in state-jurisdictional rate base for all applicable transmission owners. This proposal is clearly inappropriate. The Commission should establish the ITC's ROE based on the risks, costs, and other circumstances applicable to the ITC, rather than on either of the arbitrary standards proposed by Petitioners.

On top of the base ROE discussed above, Petitioners request approval, to be in place for a period of five years, of a series of so-called “divestiture incentives.” Assets transferred to the ITC through divestiture would be allowed a 200 basis point adder on ROE; assets contributed to the ITC in exchange for a passive ownership interest would be granted a 100 basis point adder; and assets contributed to the ITC through a lease or operating agreement would be granted a 50 basis point adder.

First, Petitioners have not demonstrated that their binary RTO proposal is superior to the Midwest ISO, and, therefore, divestiture incentives designed to obtain that structure are not appropriate. Second, even if the binary RTO arrangement is demonstrated to be superior to the Midwest ISO, Petitioners provide no evidence that transmission owners who are currently not part of the Midwest ISO require incentives to join or that transmission owners who are currently part of the Midwest ISO require incentives to remain. Third, there appears to be no reason why a transmission owner could not transfer functional control of its transmission assets to the Midwest ISO just as well as it could to the ITC—therefore, there appears to be no basis for granting an ROE adder to assets transferred to the ITC via operating agreement. Fourth, the ICC has repeatedly recommended that the Midwest ISO be given authority to lease transmission assets—that modification to the Midwest ISO Agreement would eliminate the need for an ROE adder in relationship to transmission assets transferred via lease. Finally, the ICC notes that Commonwealth Edison, and Alliant (parent of IES and Interstate) are already members of the Midwest ISO—these companies should not be granted ROE incentives to take action that they have already taken, namely transfer of transmission facility functional control.

On top of the base ROE discussed above and the ROE adders discussed above, Petitioners propose a whole set of performance and expansion incentives. For example, Petitioners propose that the ITC be granted bonuses for: (1) scheduling transmission maintenance during periods of low energy price; (2) control area operation quality that exceeds a benchmark; (3) transmission planning quality that exceeds a benchmark; (4) customer service quality that exceeds a benchmark; (5) controlling ancillary service costs and quality grid management; and (6) transmission facilities expansion.

These incentive and performance rate proposals should be examined closely. While the ICC is not completely opposed to employment of incentive and performance based rates in the context of electric transmission, the benefits for consumers must exceed the costs. Petitioners have not made that case for any of their incentive and performance rate proposals.

The ICC also urges the Commission to carefully scrutinize the proposed use of price cap regulation as the Petitioners propose. Petition at 57. Traditionally, price cap regulation has been used as a method of transitioning regulated markets to competition. It is unlikely that transmission service will be provided on a competitive basis, at least in the foreseeable future. Furthermore, there is no assurance that the quality of service will not decline under price cap regulation. The Petitioners attempt to address these concerns through a series of “quality of service benchmarks”. As proposed, these benchmarks are subjective and would be difficult to verify. More importantly, the Petitioners fail to explain who will determine if the ITC has attained the specified benchmarks and how the benefits will be shared with transmission customers.

C. Midwest ISO Appendix I

Petitioners request that the Commission find their ITC proposal consistent with the recently proposed Appendix I to the Midwest ISO Agreement which contemplates a sharing of functions between an ITC and the Midwest ISO. The Midwest ISO's Appendix I filing is currently pending before the Commission in Docket ER00-448-000.

The Commission cannot act on Petitioners' request for declaratory order until the Commission acts on the Midwest ISO's request for approval of Appendix I. In turn, the Commission's consideration of Appendix I should be conducted in light of the Commission's recently issued RTO Order 2000.

In any event, Petitioners' request to the Commission with respect to a declaratory order concerning Midwest ISO Appendix I is not an appropriate subject for a Commission declaratory order. Midwest ISO Appendix I describes the specific procedure that an ITC must engage in to obtain Midwest ISO approval and Commission approval of any ITC seeking to obtain rights under Appendix I. Issuance of a declaratory order on this issue would undermine the procedure established in proposed Appendix I. Furthermore, Commission issuance of a declaratory order on the issue of Petitioners' compliance with Appendix I would pre-judge the issues which would otherwise be appropriate once an ITC has actually submitted an application under Appendix I.

D. Proposed ITC Corporate Structure

1. Passive Ownership Interests

Petitioners express a preference for an ITC structure under which at least one existing transmission owner would outright divest its transmission assets so that a new

entity could be created to act as the Corporate Manager for the ITC. If that structure cannot be accomplished, Petitioners describe a second-best structural option which would not feature a divested corporate manager. However, in either the preferred structure or the alternative structure, transmission-owning utilities may transfer their transmission facilities to the ITC in exchange for a so-called “passive interest” in the ITC.

The Commission adopted requirements in Order 2000 concerning passive interests in RTOs. Because Petitioners’ filing was made prior to Commission issuance of RTO Order 2000, their proposal does not comport with the requirements of that Order. Petitioners’ proposal should not be approved until the details with respect to passive ownership interests are fully explained and full compliance with RTO Order 2000 reached.

2. Transfer of Operational Control to the ITC Through Lease or Operating Agreement

The Petition states that transmission owners who are unable or unwilling to contribute their transmission assets to the ITC may transfer “control and operating authority” over their transmission facilities to the ITC through leases or operating agreements. Petition at 15. The ITC will not own the transmission facilities of transmission-owning utilities who choose to participate in the ITC through this means.

One of the claimed advantages of ITCs over ISOs is that, under the ITC approach, ownership of transmission facilities is not separated from operation of those facilities. However, under the Petitioners’ proposal, at least with respect to facilities transferred to the ITC under lease agreements or operating agreements, ownership will

continue to be separate from operation. This proposed structure is strikingly similar to that proposed by the Midwest ISO. Under such circumstances proposed by Petitioners, the claimed “advantages” of an ITC structure as compared with an ISO structure are not apparent.

VII. CONCLUSION

WHEREFORE, for each of the foregoing reasons, the Illinois Commerce Commission respectfully requests that the Commission not grant the Petition for Declaratory Order as proposed. Alternatively, the ICC requests that the Commission modify and clarify the Petitioners’ proposal as described above, and for any and all other relief that is appropriate and just.

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Respectfully submitted,

ILLINOIS COMMERCE COMMISSION

Myra Karegianes
General Counsel and
Special Assistant Attorney General

Sarah Naumer
Special Assistant Attorney General
160 N. LaSalle, Suite C-800
Chicago, Illinois 60601
(312) 793-2877